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No. 56

IN THE

Supreme Court of the United States

October Term, 1939

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

v.

THE F. & R. LAZARUS & COMPANY,

Respondent.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Sixth Circuit

---

BRIEF FOR RESPONDENT

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BRIEF FOR RESPONDENT

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 16 to 24) nding in favor of the Respondent both on the facts and on ne law, is reported in 32 B. T. A. 633. The opinion of the ircuit Court of Appeals for the Sixth Circuit (R. 127 to 33), affirming the decision of the Board of Tax Appeals, reported in 101 F. (2d) 728.

JURISDICTION

The question of the jurisdiction of this Court is fully covered in the Brief for the Petitioner (pp. 1 and 2), to which reference is hereby made.

QUESTION PRESENTED

Whether this Court should reverse findings and decisions that a taxpayer operating a department store is entitled to deduct depreciation on buildings used by it in its business under the following circumstances: It erected the buildings for use in its business on land owned by it. Thereafter, pursuant to negotiations for the borrowing of money, it conveyed the land and buildings for half of their appraised value to a bank as trustee for land trust certificate holders. Its express purpose in making the conveyance was to finance a new loan to take up outstanding loans, the major part of which consisted of a construction loan for the erection of one of the buildings in question. At the same time it made the conveyance it received from the trustee a perpetual lease with privilege of purchase for substantially the same amount as it received from the trustee. The taxpayer continued to occupy the premises, to pay taxes, assessments and all expenses in connection with the property, the trustee's fees and sufficient addition to provide a fixed income based on approximately five per cent of the investment for land trust certificate holders. The lease required the taxpayer to pay into a so-called depreciation fund, for the benefit of the land trust certificate holders, up to eighty per cent of the amount advanced to the taxpayer, and permitted the payments to continue beyond that amount so that, as planned by the taxpayer and its banker, the entire issue would be retired within forty-five to forty-eight years. On the basis of this and other evidence supporting taxpayer's intention to borrow money rather than to sell real estate:

1. The Board of Tax Appeals found and decided that the transaction was in reality a mortgage, and was not one in which the taxpayer lost its right to deductions for exhaustion of the property conveyed, and that the property was being used in the business of the taxpayer;

2. Said findings were based on substantial evidence in the Record;

3. Said decision of the Board was affirmed by the Circuit Court of Appeals.

STATUTE INVOLVED

Section 23(k) of the Revenue Act of 1928 is set forth in Petitioner's Brief (p. 2) and in the Appendix to this Brief (p. 37).

STATEMENT

1. Findings of Board of Tax Appeals not in Petitioner's Brief.

Counsel for the Petitioner have given in their Brief (pp. 3 to 9, inclusive) portions only of the facts as set forth in the opinion of the Board of Tax Appeals. They have omitted certain significant parts thereof, as follows:

At the end of the paragraph at the top of page 4 of Petitioner's Brief, there is an omission of the following findings:

> "In 1928 the petitioner,[1] in a transaction involving the borrowing of money, gave to the Huntington National Bank of Columbus, trustee, a deed to the property it held in fee, and assignments of the property it held under ninety-nine year leases. Concurrently with such conveyance and assignments, the trustee leased all of the property to the petitioner for ninety-nine years, renewable for like periods, with an option to purchase the parcels to which it had title. . . . The petitioner insists that the deed was in reality a mortgage." (R. 17, 18.)

[1] Wherever "petitioner" appears in the quoted parts of the Board of Tax Appeals opinion, it refers to the taxpayer, respondent in this Court.

The last sentence of the long paragraph on page 4 of Petitioner's Brief reads in the Board of Tax Appeals opinion, instead of as set forth in Petitioner's Brief, as follows:

> "The Huntington National Bank of Columbus, one of petitioner's bankers for about 15 years, suggested a loan of $3,500,000.00 at 5 per cent based upon the issuance of land trust certificates on petitioner's real property at a price of 96.75, and the creation of a sinking fund for repayment of the loan. The proposal of the Huntington National Bank of Columbus, limited to $3,250,000.00 in amount, was accepted by the petitioner because the loan to be made under it was self-liquidating." (R. 19.)

There are also omitted from the opinion of the Board of Tax Appeals, as summarized in Petitioner's Brief, the following significant paragraphs (R. 20, 21):

> "From the undisputed testimony in the record it is clear that the petitioner's desire was to obtain a long-term loan on the security of its real property, with provision for reacquisition of unencumbered title. It was not interested in selling the property to raise the needed funds. The petitioner then considered the property conveyed to be worth around $6,000,000 and it would not have sold it for $3,250,000, the face amount of the trust certificates actually sold. The representative of the bank in the transaction testified that he did not consider that the bank was buying the property, and that the deal was merely one involving a loan with ample security. The bank had the property appraised to determine not whether the property was worth $3,250,000 to it as a buyer, but to establish the value of the land and improvements for loan purposes. The appraisal made by qualified appraisers established a value of $3,453,125 for the land and $3,056,427 for the improvements as of the time of the transaction.
>
> "The transaction was carried out in the form described instead of by a mortgage loan because of the lack of a market at that time for mortgage notes. The annual rentals were fixed on the basis of a 5 per cent return on the face amount of the outstanding cer-

tificates, an amount established by evidence to be less than a fair rental. This the petitioner recognized by making a rent charge of $375,000 on its books each year for the property. The option price of the property held in fee was fixed at an amount equal to the call price of the outstanding certificates and the amount of the quarterly payments into the depreciation fund is sufficient to retire all of the certificates within 48½ years at the call prices thereof. Up to this time the petitioner has been able to meet the requirements of the fund with certificates purchased in the open market at less than the call prices and now has on hand certificates of a face amount sufficient to meet its depreciation fund obligations for sixteen years. The petitioner desired to have the lease provide for a depreciation fund equal to the option price of the property, but it was limited to $2,600,000 in the lease in order to bring the transaction within a certain ruling of the Attorney General of Ohio.

"From a consideration of all the evidence we conclude that the deed given was in reality a mortgage, and that the transaction was not one in which the petitioner lost its right to deductions for exhaustion of the property conveyed."

2. Evidence in Support of Findings of Board.

The evidence in support of the findings of the Board of Tax Appeals is as follows:

The business of The F. & R. Lazarus & Company, which operates the largest department store in Columbus, Ohio, was founded in 1851 (R. 41). The present three buildings, on which depreciation is claimed, were built by taxpayer at different times for business purposes. The first building was started in 1908 and occupied in August, 1909 (R. 42). The cost of this building was $297,003.95 (R. 42). An addition was started in May, 1921, and occupied in that year and the following year. The cost was $258,054.71 (R. 42). A new building was started in 1925 and occupied in part through 1926 and 1927. The cost was $1,912,893.91 (R. 42). The aggregate cost of the three buildings is $2,467,952.57.

Each of these buildings was regularly used during each of the taxable years in the conduct of the taxpayer's business (R. 42). There was no demolition of any of these buildings (R. 42). All of the buildings were erected on ground owned in fee by the taxpayer, except the addition which was started in 1922, which was built on ground held by taxpayer under ninety-nine year lease acquired in 1915 (R. 42).

In the early part of 1928 taxpayer found itself in the following financial position. It had borrowed $1,700,000.00 on a ten-year mortgage at five per cent interest, in 1926, from The Northwestern Mutual Life Insurance Company (R. 32). This was used to aid in financing the construction of the latest improvement on taxpayer's property (R. 32). It had also purchased the controlling stock interest in The John Shillito Company of Cincinnati, at a cost of slightly more than a million and a half dollars. This sum had been borrowed on short term notes from A. G. Becker & Company of Chicago (R. 32). The minutes of the Board of Directors' meeting held on May 28, 1928, show the following:

> "The general finances of The F. & R. Lazarus & Company were discussed by the Secretary-Treasurer and it was recommended that an effort be made to cancel the present outstanding mortgage with the Northwestern Mutual Life Insurance Company, and to negotiate another and larger first mortgage for a period of not less than twenty-five years, or a so-called 'Fee Certificate' issue; either plan to provide an amount in excess of Three Million Dollars in order to cover the refunding of the Northwestern Mutual Life Insurance Company mortgage, and to provide most of the funds necessary for the acquisition of the Shillito interests and the surrounding property." (R. 33, Exhibit 2, R. 44.)

Fred Lazarus, Jr., the vice president and treasurer of taxpayer in charge of its finances (R. 32) asked the Huntington National Bank of Columbus and A. G. Becker &

Company of Chicago what means they could suggest for permanent or long term financing (R. 33). The only form this could take was on the security of the company's real estate (R. 33).

A. G. Becker & Company suggested a loan of $3,750,000.00 on the basis of a twenty-five year mortgage at five percent interest, the mortgage notes to be purchased at ninety-seven and a quarter. The sinking fund and trustee expense was to be $22,500.00 a year. Interest of $187,500.00 a year would have brought the annual charge up to $210,000.00 (R. 33).

The discussions at the Huntington Bank were with Mr. Gwynne Huntington, then vice president and later president, and with Mr. Lowry Sweney, the manager of the bond department (R. 33). They suggested a fee certificate issue or a so-called land trust issue, whereby they would advance taxpayer three and a half million dollars at five percent on repayment of a half of one percent a year of the principal and a trust fee of one-tenth of one percent. The price was to be ninety-six and three quarters or a discount of three and a quarter percent (R. 33). Only three and a quarter millions gross was finally taken (R. 35). The other two hundred fifty were held in reserve pending the exercise of the option to purchase the parcels covered by the ninety-nine year leases assigned to the trustee by the taxpayer (R. 35).

The proposition of the Huntington National Bank, though more expensive to the taxpayer than the Becker plan, was accepted because it was self-liquidating and the other was not (R. 33). Under the sinking fund arrangement of the Becker proposition taxpayer would have had to repay at the end of twenty-five years or refinance at that time an amount of between two and one-half and two and three-quarter million dollars. Under the Huntington Bank proposition the loan would be extinguished in forty-eight and one-half years (R. 33). As Mr. Lazarus stated,

if they financed under the Becker plan, necessitating refinancing after twenty-five years, "we believed we would be asking a new generation, probably, in management at that time, to take on certain burdens which we had caused the business by our own decisions" (R. 33). This they did not wish to do.

Before the deal was closed Mr. Sweney, the bond department manager of the Huntington National Bank, prepared a schedule of land trust retirement figures for Mr. Lazarus, showing their ultimate retirement in forty-eight and a half years (R. 33 and 39, Exhibit 3, R. 45). These figures were based on the required annual payments into the depreciation fund and purchase at the call prices of the land trust certificates (R. 38). If the land trust certificates could be purchased at less than the call prices, that would naturally reduce the period of retirement (R. 34). If the land trust certificates could be retired at par, it would take slightly less than forty-five years (R. 34). The taxpayer had at the time of hearing already acquired land trust certificates in the market without a premium and had on hand certificates that would pay requirements for the next sixteen years, which had cost the taxpayer less than par (R. 34). Taxpayer anticipated at the time the land trust certificates were issued and still anticipated at the time of hearing continuing the sinking or depreciation fund payments until all the land trust certificates were retired (R. 34). Mr. Lazarus wanted the payments into the so-called sinking or depreciation fund to be obligatory until all the land trust certificates were retired, but the bank would not consent to that because its counsel believed the certificates would not have been nontaxable under the Attorney General's opinion (1926 Opinions of Attorney General of Ohio, 375), and it was finally compromised so that the obligatory features of the depreciation fund would end when it had accumulated $2,600,000.00, but it was permissive for the

payments to continue until all the certificates were acquired (R. 34).

The land trust certificate issue was created in the following manner. The taxpayer deeded all of its real estate, on which its department store buildings were located, to the Huntington National Bank of Columbus, as trustee, (R. 42). Thereupon the Huntington National Bank, trustee, entered into an indenture of lease with the taxpayer (R. 34 and 42). Immediately thereafter the bank executed an Agreement and Declaration of Trust between itself as trustee and the holders of land trust certificates of equitable ownership in the Lazarus Store Building Site (R. 34 and 42). As a result of this transaction the taxpayer received from the bank the sum of $3,159,687.50 (R. 34 and 41). Of this amount $1,767,500.00 was paid to The Northwestern Mutual Life Insurance Company for the cancellation of its mortgage on the real estate, which still had almost eight years to run, and $1,543,750.00 was paid to A. G. Becker & Company for principal and interest on its notes (R. 41). That made an aggregate disbursement of $3,311,250.00, the difference ($151,562.50) between the proceeds of the land trust certificate issue ($3,159,687.50) and the outlay being withdrawn from current funds then in bank (R. 35 and 41).

The payment of the money and the delivery of the instruments referred to were simultaneous and they were recorded on the same date in rotation within a few minutes of each other (R. 42).

At the time that the Lazarus real estate and buildings were deeded to the Huntington National Bank for a net cash payment of less than $3,200,000.00, the same properties were appraised at $6,509,552.00 (R. 30, Exhibit 1, R. 30 and 43). The land was appraised at $3,453,125.00 and the buildings at $3,056,427.00 (Exhibit 1, R. 44). These values were fixed by disinterested men of wide experience, particularly in connection with the values of business property in the city of Columbus, and of excellent reputation

and standing in their profession (Testimony of Converse, R. 29; Beggs, R. 39; Vercoe, R. 40).

Taxpayer thought that the land and buildings were worth over $6,000,000.00 (R. 35). It would not have sold these properties to the bank or to anyone else at that time for three and a quarter million dollars (R. 35). It actually made a rent charge on its books of $375,000.00 a year as an operating expense of the business, though the rent paid under the lease was $162,500.00 (R. 35).

Before the transaction was closed the bank had had made the appraisal referred to (R. 38). When Mr. Sweney, the manager of the Huntington National Bank's bond department, who handled the transaction with Mr. Lazarus, was asked the purpose of the appraisal (R. 38), he said (R. 38), "We had to satisfy ourselves as to the value of the property; that there was a sufficient equity there to justify the loan." He also stated that it was the requirement of his bank that they would not finance any such property if the amount of the financing was more than sixty percent of the total value of the property, land and buildings, or more than the value of the land alone (R. 38). The land trust certificate issue was sold to the public for investment (R. 38). The bank's prospectus used and issued generally to the public in connection with the sale is in evidence, as Exhibit 8 (R. 38 and 159, following R. 118). This exhibit shows that the offering was confined to 3,250 out of the total of 3,500 units and that the price was to be $1,010.00 for each unit, to yield income at the rate of 4.95%. It also shows, under "Valuation," that the appraised value of the land and buildings was over $6,500,000.00 and who had made the appraisal. Under "Purchase Option—Depreciation Fund" it sets forth the provisions for the depreciation fund and the various privilege of purchase prices. Under "General Information" it says:

> "The proceeds of this financing which is the first that the company has ever done with the public are

largely being used for the acquisition of new properties."

Mr. Sweney testified that in closing the land trust certificate transaction with the taxpayer he did not consider that the Huntington National Bank was purchasing the properties from taxpayer but he considered that they were doing a financing job for it (R. 38). The Huntington Bank had been the bankers for taxpayer for several years (R. 36). There was no change in the operation of taxpayer's business or its method of conducting business between the time before the land trust certificate issue was made and afterward (R. 42).

The lessor did not attempt to take any depreciation on the buildings (R. 37).

The Indenture of Lease (R. 34, Exhibit 6, R. 51 to 95) refers at the outset to the Agreement and Declaration of Trust "to be recorded in the Recorder's Office of Franklin County, Ohio, following the recording of this Lease in said office" (R. 51). The lease is for ninety-nine years commencing June 1, 1928, and renewable forever on the same terms, except that there is a privilege of purchase only during the first term of ninety-nine years (R. 54 and 93). The privilege of purchase carries a three percent premium from June 1, 1933, to May 31, 1938, a two percent premium thereafter to May 31, 1948, and a one percent premium during the balance of the term (R. 59). Required annual payments into the depreciation fund were one-half of one percent of the maximum amount of land trust certificates at any time outstanding (R. 56). The payments into the fund and interest and income thereon were to accumulate until they reached the amount of $2,600,000.00 (R. 56). Any assignment of the lease would operate to transfer to the assignee all lessee's rights in the depreciation fund (R. 56). This fund could be invested only in United States government bonds

or in land trust certificates issued on the leased property (R. 57). Upon the exercise of the privilege of purchase the amount of land trust certificates in the depreciation fund was to be credited on the purchase price (R. 59). But if by the end of the first term the privilege of purchase had not been exercised or in case of the termination of the lease on account of the taxpayer's default, the fund was to become the absolute property of the lessor (R. 58). The lessee was to pay the taxes or other charges on the depreciation fund (R. 58).

It is provided that the lessee, on exercise of the privilege of purchase, is to get only the title the lessor had at the date of lease as to which the indenture recites the lessee is satisfied (R. 60). In case of condemnation of a substantial part of the demised premises the lessee agrees to exercise the option to purchase (R. 61). There is to be no diminution of rent because of any appropriation to public use of any part of the demised premises (R. 61). There is no diminution of rent in the event of the destruction of the buildings by fire or otherwise (R. 66).

There are no exceptions to the lessee's covenant to keep and maintain any and all buildings and improvements that may at any time during the term be or be erected or placed upon the demised premises, in a safe, tenantable and good condition, order and repair (R. 78). The lessee is to pay all taxes (R. 62) and insurance (R. 64). The lessee agrees not only to repair and replace, but also to reconstruct any improvements that suffer loss, damage or destruction (R. 66). If the proceeds of insurance are not sufficient to restore or rebuild the buildings on the premises, the lessee will furnish funds with which to repair or rebuild them (R. 68).

In case any building is torn down or removed by lessee the new buildings, together with the old ones remaining on the property, must have a reasonable cost and value to

aggregate not less than $3,500,000.00 and must be a business building, adapted to office, commercial or mercantile purposes (R. 73). The lessee is to bear the sole cost of erecting the buildings (R. 74). The covenant of quiet enjoyment is limited to a warranty against any person claiming through or under the lessor during the term of the lease (R. 80). The lessor is not to be liable under any expressed or implied covenants of title to the demised premises or any estate or interest therein, for any damage whatsoever to the lessee (R. 81).

The Agreement and Declaration of Trust (R. 34, Exhibit 7, R. 95 to 118) shows that the ordinary duties of the trustee are restricted to the collection of rent from the trust estate and the distribution of the net rentals to the land trust certificate holders (R. 111). The land trust certificate holders have no right to partition the trust estate (R. 112). The trustee may deal with the personal representatives of any deceased beneficiary, and is not required to determine or look to the heirs (R. 112). The trustee does not warrant its title as owner of the premises or make any representations with reference thereto, nor does it warrant the validity of the lease (R. 113). The trust itself ends at the expiration of the first term of ninety-nine years, and the trustee may then either distribute in kind or sell and distribute the proceeds (R. 117).

SUMMARY OF ARGUMENT

The taxpayer is entitled to deduct depreciation in its income tax returns for the years 1930 and 1931, on the buildings which it erected on its land and used and still uses in its trade or business as a department store. It has not parted with its economic interest in these buildings, as claimed by the Petitioner, because it did not intend to, and did not make, a sale when it conveyed the property to a bank as trustee for land trust certificate holders and took

a lease with privilege of purchase for substantially the amount received for the conveyance. This is evident from the uncontradicted testimony of all the witnesses and the documentary evidence. All the characteristic indicia of mortgage rather than sale are present, such as: the prior debts of debtor; its applications to lenders of money, not purchasers of real estate; inadequacy of consideration; continued occupancy and payment of taxes by grantor; that reconveyance was to be made on payment of the amount of the consideration, with diminishing premium, and interest; the payment of a rental that would assure the certificate holders of the equivalent of interest on their investment; and the obligation to repay at least 80% of the consideration and the plan of both parties for the repayment of it all; and other indicia set forth in the body of this Brief.

Based on this testimony the Board of Tax Appeals found that it was the intention of the parties to create a loan with the land as security and not to make a sale. Therefore the taxpayer had not parted with its economic interest and was entitled to depreciation. The Court of Appeals affirmed.

It is submitted that these findings and decisions, supported as they are by substantial evidence, are binding and conclusive.

There is no estoppel, as claimed by the Petitioner, because: (1) it was not pleaded or proved at the trial; (2) Petitioner, the government, not having been a party to the transaction or misled to its detriment, cannot set it up; and (3) the parties and their privies were fully conversant with the entire transaction and were on notice from the prospectus and the recorded documents.

It is not necessary for the taxpayer to hold the legal title to property in order to be entitled to depreciation. A lessee which has an economic investment in the depreciating assets is entitled to it, as is also a conditional vendee.

As shown later in this Brief a decision in the instant case contrary to the decisions below would create confusion in the administration of the Income Tax Law and furnish a device for avoidance of taxes, and it would seriously interfere with reorganizations under the Bankruptcy Law and in equity.

ARGUMENT

I

The findings and decision of the Board of Tax Appeals in this case, supported as they are by substantial evidence, and affirmed by the Circuit Court of Appeals, are conclusive.

The finding on which we rely is as follows:

> "From a consideration of all the evidence we conclude that the deed given was in reality a mortgage and that the transaction was not one in which the petitioner lost its right to deductions for exhaustion of the property conveyed." (R. 21.)

In *Colorado Bank* v. *Commissioner*, 305 U. S. 23, this Court said (p. 26):

> "Dominant purpose was a question of fact for determination by the Board."

While in that case this Court was referring to the question whether or not a gift was made in contemplation of death, the same principle applies to this case where the question is whether or not a conveyance with lease back and privilege of purchase was intended to be an outright sale or security for a loan. The Board, on the basis of undisputed evidence, found this dominant intention, and its decision was affirmed by the Circuit Court of Appeals.

The indicia of loan with security rather than outright sale, which support the Board's findings, may be summarized from the Board's findings and the statement of evidence, as follows:[2]

1. The prior indebtedness of the taxpayer, over half of which was on a construction mortgage.

2. The desire of the taxpayer to refinance its indebtedness for repayment over a long period on the security of its real estate. The greater part of the original indebtedness was on a construction loan in connection with one of the buildings on which depreciation is claimed.

3. The application to persons who were in the business of lending money and not to such as might be buying real estate.

4. The gross inadequacy of the consideration as compared with the real value.

5. The desire to refinance in such a way that the loan would become self-liquidating over a period of years, rather than requiring refinancing at a later stated period.

6. The preparation of the schedule of land trust retirement figures by Mr. Sweney, the Bank's bond department manager, for Mr. Lazarus, showing the ultimate retirement in forty-eight and one-half years or earlier, depending upon the price paid for the outstanding land trust certificates.

7. The obligation to retire at least 80% of the certificates through the so-called depreciation fund, which would make the retirement of the balance before the end of the first ninety-nine years, when the privilege of purchase expired, an economic necessity.

8. The annual rental charge to operations of $375,000.00 on the company's books, as against an actual rental pay-

[2] See *In re Euclid Doan Co.*, 6 Cir., 104 F. (2d) 712, at p. 715, and 1 *Jones on Mortgages* (8th ed.), Sec. 323 *et seq.*, pp. 404 *et seq.*

able under the lease with privilege of purchase of $162,500.00.

9. The retention of possession by the taxpayer and the continued operation in the same manner as previously, after the conveyance and lease back.

10. The continued payment of taxes by the taxpayer.

11. The option to repurchase for substantially the same amount as was received by the taxpayer and the payment of a rental equal to an interest payment and of all expenses so that the investors would receive the precise interest stipulated.

12. The privilege of purchase price became less as time advanced, whereas the usual practice is in options to purchase involving sales that the option price becomes greater as time elapses.

13. On exercise of the privilege of purchase the lessee was to get only the title that the lessor had at the date of lease, with which the lessee agreed it was satisfied at the time of the lease.

14. In case of the condemnation of a substantial part of the demised premises the lessee would be bound to exercise the option to purchase.

15. There was to be no diminution of rent because of appropriation to public use of any part of the demised premises or in the event of destruction of the buildings by fire or otherwise.

16. The lessee agreed not only to repair and rebuild but also to reconstruct any improvements that might suffer loss through damage or destruction whether the proceeds of insurance were sufficient for these purposes or not.

17. The trustee might deal with the personal representatives of any deceased beneficiary and was not required to determine or look to the heirs.

18. The fact that all the persons active in the transaction testified that it was their intention to have a loan on the security of the real estate, and not a sale.

A. *This Court does not substitute its conclusions as to facts for that of the Board.*

The Commissioner cites as authority for review of the Board's decision, as affirmed by the Circuit Court of Appeals, the following cases (Brief of Petitioner, p. 12):

> *Helvering* v. *Tex-Penn Co.*, 300 U. S. 481, 491;
> *Bogardus* v. *Commissioner*, 302 U. S. 34, 39;
> *Helvering* v. *Rankin*, 295 U. S. 123, 131.

But, in the *Rankin case* (p. 131), the Court said:

> "The function of the court is to decide whether the correct rule of law was applied to the facts found; and whether there was substantial evidence before the Board to support the findings made."

There is nothing inconsistent with this in either the *Tex-Penn Company* or the *Bogardus* case. In the former, this Court said, at page 490:

> "They (the findings of the Board) must be taken as established if supported by substantial evidence. . . ."

And again, on page 394:

> "The validity of the ultimate finding above quoted is to be tested by what in fact was done rather than by the mere form of words used in the writings employed."

In *Helvering* v. *National Grocery Company*, 304 U. S. 282, this Court reaffirmed the doctrine of the *Rankin* case, as set forth in the language above quoted, and said:

> "To draw inferences, to weigh the evidence and to declare the result was the function of the Board. *Halburd* v. *Commissioner*, 296 U. S. 300, 306; *Elmhurst Cemetery Company* v. *Commissioner*, 300 U. S. 37, 40."

Applying the rules laid down in these cases, there are two criteria by which to test the decision of the Board. The first test is whether the correct rule of law was applied to the findings. As to this, we do not understand that there is any dispute: If the transaction was in reality a mortgage, as found by the Board, the Commissioner has not disputed that the taxpayer is entitled to take depreciation on its buildings. The second question is whether the findings of fact of the Board are supported by substantial evidence. In view of the testimony that has been detailed and the rules of law applicable, there can be no question that the findings of the Board are supported by substantial evidence. Whatever the inferences that might have been drawn by the Board, all such questions are now concluded by the Board's findings and decision and by the affirmance by the Court of Appeals.

II

The taxpayer need not have the legal title in order to be entitled to an allowance for depreciation.

Section 23 (k) of the Revenue Act of 1928 provides that in computing net income there shall be allowed as a deduction:

> "A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence."

There is no doubt that the property on which depreciation is claimed is used in the taxpayer's trade or business. The taxpayer erected the buildings at its own cost and, therefore, finds itself in the position of the lessee taxpayers who were allowed depreciation in *Duffy* v. *Central R. Co. of New Jersey*, 268 U. S. 55; *Cogar* v. *Commissioner*, 6 Cir., 44 F. (2d) 554; and *Gladding Dry Goods Co.* v.

Commissioner, 2 B. T. A. 336, 338; unless it has since the erection of the buildings recouped its original investment therein. But that is the very thing that the Board of Tax Appeals found, on substantial evidence to support its findings, did not happen, and, therefore, taxpayer has not lost its economic interest in the buildings. See *Commissioner* v. *H. F. Neighbors Realty Co.*, 6 Cir., 81 F. (2d) 173.

A conditional vendee, though he has not the legal title, is entitled to deduct depreciation.

In I. T. 2275 (I. R. Cumulative Bulletin V-1, page 62), it was held that a vendee of real estate under an executory contract of sale on deferred payments is entitled to depreciation from the time possession and the burdens and benefits of ownership are transferred to him, though he may, under state law have no title to the property until the entire purchase price is paid.

In *Burroughs Adding Machine Co.* v. *Bogdon*, 8 Cir., 9 F. (2d) 54, the third paragraph of the syllabus reads as follows:

> "A conditional contract for sale of personal property is not changed into a lease by designating instrument as lease, parties as lessor and lessee, and consideration as rentals or rent; the governing consideration being legal effect of instrument as gathered from all its provisions."

The instrument in question in that case provided for the possession and use of the machines by the "lessee," $75.00 being paid down upon execution and $47.22 monthly during the term until $424.97 was paid, after which the lessee had the option to purchase the machines upon the payment of an additional sum of $47.22. The Court (9 F. [2d] at p. 56) said:

"The final payment, which is nominally the purchase price, is so small in comparison with the entire purchase price as to leave no real choice to the 'lessee.' The obvious purpose was to dispose of the machine under such conditions that when the 'lessee' had paid the 'rental' he could not afford to fail the relatively small final payment to obtain it. This would have been the obvious and natural, if not the inevitable, result. Evidently it was what the parties desired and intended to accomplish."

Petitioner claims that taxpayer in the instant case is in the same situation as the taxpayer was in *Weiss* v. *Wiener*, 279 U. S. 333 (Brief, pp. 23 and 24). That case takes a realistic view of the question of depreciation. All that it decides is that one whose business is investment in real estate on ninety-nine year leases, who had nothing to do with the erection of the buildings and had, therefore, never been affected by their depreciation cannot make a deduction therefor. This is obvious from the language of Mr. Justice Holmes (279 U. S. at pp. 335-6), as follows:

"He was allowed all sums paid for repairs but nothing for the estimated obsolescence for which he had not paid. . . . It might never fall on him."

In the instant case there is no question but that, realistically speaking, taxpayer owns the property. It erected the buildings, which was not the case with Wiener. It is substantially bound to acquire the fee title to the property, which was not the case with Wiener. It is conducting its own business on the property in question, which was not the case with Wiener. Wiener had even reassigned some of the leases on which he was claiming depreciation, and had no interest therein, except for the profit from his

transaction and a possible contingent liability in case his assignee or sub-lessee defaulted. Some of Wiener's leases had been surrendered to the lessor. That would not be possible in the instant case except in the event of the insolvency of the taxpayer.

III

The transaction whereby taxpayer conveyed its property to the bank as trustee and leased it back was in substance an encumbrance of its property for a loan and not a sale.

A. *The substance of the transaction may be shown by oral testimony and circumstances outside of the written instrument of conveyance.*

This was decided in *Peugh* v. *Davis*, 96 U. S. 332, and has apparently never been questioned since. See *Brick* v. *Brick*, 98 U. S. 514 and *United States* v. *Shelby Iron Co.*, 273 U. S. 571, 578.

B. *A conveyance of real estate, although absolute in form, if intended by the parties to be security for a loan, is in fact a mortgage.*

The leading case on this proposition is *Russell* v. *Southard*, 12 Howard 139. See, also, the following:

Hughes v. *Edwards*, 9 Wheaton 489.
Morris v. *Nixon*, 1 Howard 118.
Peugh v. *Davis*, 96 U. S. 332.
Teal v. *Walker*, 111 U. S. 242.
White v. *Redenbaugh*, 41 Ind. App. 580.
Edrington v. *Harper*, 3 J. J. Marsh. (Ky.) 353.
Woodward v. *Pickett*, 8 Gray (74 Mass.) 617.
Kraemer v. *Adelsberger*, 122 N. Y. 467.
Weiseham v. *Hocker*, 7 Okla. 250.

This rule is applied in the following federal income tax cases:

United National Corp. v. *Commissioner*, 33 B. T. A. 790.

First National Bank in Wichita v. *Commissioner*, 10 Cir., 57 F. (2d) 7, certiorari denied, 287 U. S. 636; as well as in the instant case and in

Commissioner v. *H. F. Neighbors Realty Co.*, 6 Cir., 81 F. (2d) 173.

Where there is a conveyance of real estate and the vendee at the same time delivers to the vendor a contract by which he agrees to reconvey the premises by a specified time, upon the repayment of the purchase money with interest, the circumstances furnish presumptive evidence that the deed, although absolute upon its face, was intended as a mortgage, and it will be so held in equity.

Marshall v. *Stewart*, 17 Ohio 356.
Cotterell v. *Long*, 20 Ohio, 464.
Helmbold v. *Helmbold*, 25 Ohio App. 32.
Coleman v. *Miller*, 8 Ohio Dec. Repr. 179.
Bailey v. *Poe*, 142 Md. 57.
Obrecht v. *Friese*, 148 Md. 484.
Nugent v. *Riley*, 1 Metcalf (42 Mass.) 117.
Peoples Street Railway Co. v. *Spencer*, 156 Pa. 85.
1 *Jones on Mortgages* (8 Ed.), Section 317, pp. 393 and 394.
79 *A. L. R.* 938, Introduction to Annotation Entitled "Deed Absolute on its Face, with Contemporaneous Agreement or Option for Repurchase by Grantor, as Mortgage *vel non*."
16 *Ruling Case Law*, 545, Landlord and Tenant, Section 16.

Proof that an instrument in the form of a lease is intended to be a mortgage is not limited to equity proceedings. It may be set up as a defense in an action by the lessor to dispossess the tenant for non-payment of rent. *Reich* v. *Cochran*, 151 N. Y. 122, at 127. See, also, I. T. 2679 (I. R. Cumulative Bulletin XII-1, p. 103).

C. *It is a question of proof whether or not a conveyance was in fact given as security for a loan.*

In *Russell* v. *Southard*, 12 Howard 139, the conveyance, absolute in form, was held to be a mortgage, and the grantor entitled to redeem. The Court said that a question of great importance was to inquire whether the consideration was adequate to induce a sale (p. 148). There was also oral testimony, which was disputed by the defendant, that it was the intention of the parties to create a mortgage and not make a purchase and sale. The Court said (p. 151):

> "In doubtful cases the Court leans to the conclusion that the reality was a mortgage, and not a sale."

Citing *Conway* v. *Alexander*, 7 Cranch 218, and other cases.

Again, on page 152, the Court said:

> "The memorandum does not contain any promise by Russell to repay the money, and no personal security was taken; but it is settled that this circumstance does not make the conveyance less effectual as a mortgage."

The cases cited in this Brief under paragraphs A and B, *supra*, are to the same effect. The cases cited in the Brief of Counsel for Petitioner (pp. 14 to 17) do not lay down any different rule, but were cases where the Court found that the evidence did not support the contention that the conveyance was a mortgage. For instance, in *Conway* v. *Alexander*, 7 Cranch 218 (Petitioner's Brief, p. 14), it was not shown that the consideration was inadequate and it was shown that the grantor intended to make a sale and not a loan. The Court said, on page 240:

> "This, then, is a case in which there was no previous debt, no loan in contemplation, no stipulation for the repayment of money advanced and no proposition for or conversation about a mortgage."

Again, on page 241:

> "The excessive inadequacy of price would, in itself, in the opinion of some of the judges, furnish irre-

sistible proof that a sale could not have been intended. . . . But the testimony on this point is too uncertain and conflicting to prevail against the strong proof of intending a sale and purchase, which was stated."

And on page 237:

"Doubtful cases have generally been decided to be mortgages."

In *Slutz and Larue* v. *Desenberg*, 28 O. S. 371 (Petitioner's Brief, pp. 14 and 21), it appeared that the grantor was anxious to sell his property because he was leaving for California and wanted to raise some money for the trip. He delivered possession to the vendee contemporaneously with the conveyance, there was no evidence of gross inadequacy of consideration, and the vendor's evidence that he did intend the transaction to be a loan was disputed by other witnesses.

IV

There is no estoppel against the taxpayer in this case.

A. *Estoppel was neither pleaded nor proved before the Board of Tax Appeals and should not, therefore, be considered by this Court.*

Helvering v. *Salvage*, 297 U. S. 106, 109, and *General Utilities & Operating Company* v. *Helvering*, 296 U. S. 200, 206, are decisive of this point.

B. *The Petitioner cannot set up an estoppel because no representation was made to him or anyone in privity with him by the taxpayer.*

A stranger to the transaction cannot set up an estoppel. *Deery* v. *Cray*, 5 Wall. 795; *Branson* v. *Wirth*, 17 Wall. 32; and *Kitzmiller* v. *VanRennselaer*, 10 O. S. 63, illustrate this principle, which goes back to *Coke on Littleton*, Section 352a.

C. *The doctrine of estoppel could not apply here because the bank, which made the loan to the taxpayer, was fully advised as to all the circumstances.*

See *Brant* v. *Virginia Coal & Iron Company*, 93 U. S. 326.

Even if the ultimate land trust certificate holders, who may change from day to day, were involved, they were advised of significant circumstances by the bank's prospectus (Exhibit 8, R. 159, ffg. R. 118), their certificates (Exhibit 7, R. 100), and the lease and declaration of trust, which were duly recorded and which are incorporated by reference in the certificates. These show the gross inadequacy of the price paid for the property, the purchase option at a fixed price which decreases as time elapses, the payment of the so-called rental which is the fixed interest payment on the loan, the so-called depreciation fund which legally requires the repayment of 80% of the purchase price and economically requires the repayment of the balance, that the transaction was one of "financing" by the taxpayer, and other circumstances referred to in the Statement, (*supra*, p. 10 of this Brief).

The fact that counsel for the bank may have given their opinion that the land trust certificates were not subject to then existing Ohio personal property taxes under a ruling of the Attorney General of Ohio (1926 Opinions, Attorney General of Ohio, 375) is not controlling. *Ward* v. *Ward*, C. C. S. D. N. Y., 131 Fed. 946, 953, affirmed, 145 Fed. 1023.

In *In re Euclid Doan Co.*, 6 Cir., 104 F. (2d) 712, the question was whether debtor in reorganization under 77 B of the then Bankruptcy Act,[4] which had conveyed its property but retained possession under a renewable ninety-nine

[3] The trustee, not the beneficiary of a trust, paid personal property taxes under the Ohio law then in force. General Code of Ohio, Sec. 5370, 1 Page's Annotated Ohio General Code (1926 ed.). Under the terms of the lease in the instant case the taxpayer was required to reimburse the trustee-lessor for any taxes it was required to pay. (Exhibit 6, Art. Five, R. 63.) See on this point, Goldman and Abbott, *Land Trust Certificates* (1928), 2 U. of Cin. L. Rev. 255, at p. 279.

[4] 48 Stat. 912, 11 U. S. C. A., Sec. 207.

year lease, in a land trust certificate transaction similar to that in the instant case, could continue in occupation of the premises or must surrender them to the trustee because of default under the lease. The question turned on whether the transaction was a sale or a mortgage. The master commissioner, to whom the issue was referred, found the transaction a mortgage. His report was confirmed by the District Court and upheld by the Circuit Court of Appeals, following the *Neighbors* (81 F. [2d] 173) and the instant case (101 F. [2d] 728).

The question of estoppel was raised by the trustee for land trust certificate holders and overruled. The Court said (104 F. [2d] at p. 715):

> "The party asserting estoppel must be able to show that he has been injured by the conduct of the other party and that he had no knowledge or means of knowledge of the truth."

This question is vital in the reorganization of any company which has financed its needs through a land trust certificate issue. A contrary decision would make such reorganizations impracticable. In every case where the question has been raised in reorganizations in the District Courts, they have assumed jurisdiction over the real estate and treated the land trust certificate holders as secured creditors.

In re Hotel Gibson Co., S. D. Ohio, 11 F. Supp. 30.[3]

In the case of *In re Westover*, 2 Cir., 82 F. (2d) 177 (Petitioner's Brief, p. 23), estoppel was successfully asserted by the holders of mortgage participation certificates against the original seller of these certificates and

[3] See unreported cases listed in 52 Harv. L. R. 1153, note 29, and also *In re Sycamore Hammond Realty Co.*, Case No. 13031 in D. C. S. D. Ohio, W. Div.

its affiliated corporation, which had issued them. The certificate holders were directly concerned in the reorganization proceeding under 77 B of the then Bankruptcy Act. The estoppel was set up by immediate parties to the transaction against another party to the transaction. The court said that no private agreement to which the certificate holders were not parties or privies and of which they had neither knowledge nor notice could be set up to their prejudice in that proceeding.

In the instant case the land trust certificate holders are not parties nor directly interested in the proceeding. As shown previously, the bank with which taxpayer dealt understood the transaction fully and the certificate holders were put on notice by statements in the prospectus and in the recorded instruments, and there is no evidence in the Record that anyone of them was misled to his detriment.

V

The taxpayer has not recovered its investment in its business property, and, therefore, is entitled to continue to take depreciation on its buildings as it did before the land trust certificate transaction took place.

This point was decided in *Commissioner* v. *H. F. Neighbors Realty Co.*, 6 Cir., 81 F. (2d) 173,* in which case the firm of counsel for taxpayer in the instant case filed a brief as *amici curiae*. No application for writ of certiorari was filed by counsel for the Commissioner. While the main point in the *Neighbors* case was the question of taxable gain or loss on the transfer to the trustee for land trust certificate holders, that case also decided (p. 176) that the Neighbors Realty Company, which was in the position of the taxpayer in the instant case, could take depreciation on its buildings.

* See to the same effect I. T. 2679, Internal Revenue Cumulative Bulletin XII-1, page 103 (June, 1933).

It is in evidence in the instant case that the buildings were erected over a period of years from 1908 to 1927 at a total cost of $2,467,952.57 (R. 42). There is no evidence as to the basis on which taxpayer held the land. Therefore, it is not apparent from the Record whether the $3,159,687.50, which was received from the Huntington Bank, was in excess of the cost to taxpayer of the land and buildings. There has been no attempt on the part of the Commissioner to tax any gain, if any such existed, nor on the part of the taxpayer to deduct any loss.

The rule contended for by the Commissioner, which would make the conveyance to the trustee for land trust certificates a closed transaction for the determination of gain or loss, would only work confusion in these transactions and might ultimately work to the disadvantage of the government in connection with its income tax collections. For instance, if the amount of money that the company was borrowing was less than its cost basis, and it had a profitable year, a corporation could use a similar transaction as a device to reduce considerably its income taxes in that year. On the other hand, if it had had large losses in the tax year and would have a similarly large profit as a result of financing through a land trust certificate issue, it could make this financing without paying any taxes and henceforth hold its land and buildings on a higher basis, when it exercised the privilege of purchase.

If the contention of counsel for Petitioner (Brief, p. 23) is valid, that the taxpayer recovered the full value of the property because the lease with privilege of purchase was worth the difference between the real value of the property and the cash paid, then a transaction like this could be used as a device for amortization of such excess value over the period of the lease. For instance, the lease could be made for ten years and then there would be an amortization of about $325,000.00 a year, instead of merely a $50,-

000.00 deduction for depreciation. An example of this appears in the case of *Robert A. Taft* v. *Commissioner of Internal Revenue*, 27 B. T. A. 808. The petitioner in that case had offered to purchase the property for $185,000.00, $50,000.00 in cash, $25,000.00 at the end of five years, $25,000.00 at the end of ten years and the balance to be evidenced by privilege of purchase, without obligation, contained in a fifteen year lease. The petitioner-taxpayer in that case claimed at the outset the right to amortize his payment of $50,000.00 over the life of the lease. The Commissioner had already allowed him depreciation at the rate of four per cent on $20,000.00, the value of the buildings on the property. The Board found that he was not entitled to amortization as he was required to pay $100,000.00 out of a total of $185,000.00 purchase price and there was, therefore, an economic necessity for his paying the other $85,000.00 before the end of the lease. He was, therefore, to be treated as in substance the owner of the property rather than a lessee who had paid a premium for a lease which would be lost at the lease's termination. In this the Board sustained the Commissioner's contention.[7]

It is obvious that sound business judgment would require this result and the possibility of taxpayer's not reacquiring the fee by exercise of privilege of purchase is too remote to be considered. A slight possibility is not sufficient to deprive the taxpayer of an otherwise proper deduction.

Commissioner of Internal Revenue v. *The Hub, Inc.*, 4 Cir., 68 F. (2d) 349, 351.
Cf. *Burroughs Adding Machine Co.* v. *Bogdon*, 8 Cir., 9 F. (2d) 54.

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[7] See to the same effect: *Pig and Whistle Company* v. *Commissioner*, 9 B. T. A. 668, and *E. M. Diebold* v. *Commissioner*, 19 B. T. A. 438.

In the instant case the taxpayer is required by the terms of the lease itself to pay into a depreciation fund for the ultimate benefit and security of the land trust certificate holders at least $2,600,000.00 out of a total purchase price of approximately $3,250,000.00 and this amount would become the property of the land trust certificate holders in case of lessor's default or failure to exercise the privilege of purchase within the first ninety-nine years of the lease. (See *supra*, p. 12.)

VI

Cases cited by Commissioner's Counsel distinguished.

It will not be necessary to discuss all of the cases cited in Petitioner's Brief, as many of them are cited merely for obvious points of law and others, as previously shown,[1] turn on the peculiar facts in each case and the findings of the trial court on those facts.[2]

In *Nitkey* v. *Ward*, 199 Minn. 334 (Petitioner's Brief, p. 22), there was a finding of the trial court based on the evidence in that case, that it was not the mutual intention of the parties to create a mortgage rather than to have a sale. The plaintiff in that case was the only witness to support his theory of mortgage (p. 342), and his testimony was shaken in this and other respects. The plaintiff had an option to purchase the property from strangers for the sum of $1,025,000.00 and contemporaneously with the exercise of the option he conveyed the property to a trustee designated by the bankers who arranged the transaction, for $930,000.00. The privilege of purchase given in the lease to a corporation, not the grantor, was $1,050,000.00.

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[1] See, for instance, *Stutz and Larue* v. *Desenberg*, 28 O. S. 371 (Brief, *supra*, p. 25); *Conway* v. *Alexander*, 7 Cranch 218 (Brief, *supra*, p. 24.)

[2] For example, *American National Bank* v. *Groft*, 56 S. D. 460; *Lemond Co.* v. *McNabb*, 109 W. Va. 142; *Gibson* v. *Kraay*, 3 O. L. R. 671, affirming 2 O. N. P. (N.S.) 537.

At the same time first mortgage leasehold bonds were issued for $247,500.00 by the corporation. The only investment that the plaintiff had in the entire transaction was $15,000.00, which was the earnest money deposited in escrow with the Chicago Title & Trust Co. (p. 337). It is thus obvious that the plaintiff in that case had no investment in the property, was not seeking a loan but merely a speculation out of which he could make money through the floating of investment securities, and that there was no inadequacy of price. All of the witnesses except the plaintiff himself testified that it was the intention to have an outright sale and not a mortgage by way of security. On this record the trial court found as a fact that there was no equitable mortgage and the appellate court said that that finding was amply supported by the evidence. The Court said, on p. 340:

> "The finding of the trial court either way will not be disturbed even where there is strong evidence to the contrary."

In *City National Bank Building Co.* v. *Helvering*, App. D. C., 98 F. (2d) 216 (Petitioner's Brief, p. 22), the finding of the Board of Tax Appeals was in favor of the Commissioner on the state of facts existing in that case. The Board said (34 B. T. A. 93, at p. 99):

> "The facts in the present case are different in some respects from the facts in the *Lazarus* and *Neighbors* cases. It may be that these differences serve to distinguish the cases. The transactions in the *Lazarus* and *Neighbors* cases were initiated by existing corporations in order to refinance their indebtedness. Here the transactions were initiated by bankers who desired some business."

In that case investment bankers obtained an option to purchase the stock of a Nebraska corporation for $940,

000.00. The corporation owned an office building in Omaha subject to a mortgage of $560,000.00. The bankers formed a new corporation and assigned this option to it. The Nebraska corporation then conveyed the land and building to the new corporation, the taxpayer, which in turn conveyed the property to the Cleveland Trust Company, which executed a lease of the building to the taxpayer for a term of ninety-nine years with option to purchase. The Trust Company also executed a declaration of trust covering one thousand land trust certificates of a face value of $1,000.00 each, with interest at 5½% per annum and no depreciation fund. The taxpayer received $930,000.00 from the sale of these certificates. It simultaneously executed a mortgage on its leasehold and issued $600,000.00 face value 6½% fifteen-year sinking fund bonds for which it received $540,000.00. The taxpayer thus received from the sale of the land trust certificates and bonds $1,470,000.00. Its disbursements in connection with the transaction were $940,000.00 for the stock of the original owner, $560,000.00 to retire the old first mortgage and $25,000.00 commission, or a total of $1,525,000.00. The difference between the receipts and disbursements of $55,000.00 was made up by a contribution in this amount by the bankers. The taxpayer in the case claimed, and was allowed, a deduction for amortization of its leasehold.

The City National Bank Building Company had never used the building on which it sought to deduct depreciation in its trade or business before it became a lessee, it acquired the lease purely for speculative purposes, and it made no substantial investment in the property which it did not contemporaneously recover. It was therefore in the position of the taxpayer in *Weiss* v. *Wiener*, 279 U. S. 333, who acquired the lease for investment or speculative purposes.

The cases of *National Stores* v. *Board of Equalization*, 111 W. Va. 203, and *Narragansett Mutual Fire Insurance Co.* v. *Burnham*, 51 R. I. 371, are cases of interpretation of local taxation statutes, in which there was no evidence outside of the written documents, to prove the real intention of the parties.

Senior v. *Braden*, 295 U. S. 422, (Petitioner's Brief, pp. 17 and 18) arose out of an attempt of the Ohio authorities to tax land trust certificates under a revision of the tax laws passed in 1931 (114 Ohio Laws 714), three years after the transaction in the instant case. The Supreme Court of Ohio held the certificates taxable, 128 O. S. 597. This Court, on appeal, held that under the Fourteenth Amendment of the Constitution of the United States, Ohio could not impose an intangible property tax on land trust certificates owned by Ohio residents, whether these certificates represented land outside of Ohio or within Ohio. The basis for this decision was that the interest of those particular land trust certificate holders was an equitable interest in real estate and that taxing the certificates themselves as well as the land was double taxation in violation of the Fourteenth Amendment. The land trust certificates sold by the Huntington National Bank were not involved in that case (295 U. S. at p. 428, note 3). The records in the *Senior* case and in the instant case are entirely different, as are the parties. The only substantial evidence offered in the *Senior* case as to the nature of the land trust certificate transactions consisted of copies of the land trust certificates, the leases and the declarations of trust. There was no pleading or evidence offered by either side as to the circumstances under which the leases and declarations of trust were made, as to the intentions of the several owners in conveying their properties to trustees and receiving back leases with privilege of purchase, as to the values of the properties, as to whether there was pre-existing indebted-

ess for construction loans or otherwise, or as to the forts made by the owners of the property to make other nancial arrangements. In the absence of evidence to the ntrary, a deed is considered, even in equity, as an abso-te conveyance, whether there is a lease back or not.[19]

In the case of *Commissioner* v. *H. F. Neighbors Realty o.*, 6 Cir., 81 F. (2d) 173, the Commissioner made the me contention that he is making here as to the supposed nding effect of *Senior* v. *Braden*, 295 U. S. 422, in a milar situation to that involved in the instant case. The ourt considered the argument and rejected it for reasons ated on pages 175 and 176 of that opinion.

In the instant case, as in the *Neighbors Realty Company se*, there was substantial evidence on which the Board of ax Appeals based its findings and decision in favor of the xpayer. As pointed out by the court below in the instant se, it and the *Neighbors* case are substantially alike, xcept that the instant case is a stronger case for the tax-ayer than was the *Neighbors* case. 101 F. (2d) 728, at ages 729 and 730.

CONCLUSION

In income tax matters, the substance, not the form, con-rols. The Board of Tax Appeals, on a full presentation f evidence and arguments, held that the transaction in-olved here is, in reality, a mortgage and that, therefore, he taxpayer is entitled to take the depreciation claimed n the buildings which it uses in its business. The Com-issioner does not and cannot dispute that the Board pplied the correct rule of law, namely, that if the transac-on is, in substance, a mortgage, the taxpayer is entitled o a deduction from its income tax for depreciation. All

[19] See *Wallace* v. *Johnstone*, 129 U. S. 58, at p. 64 (Petitioner's Brief, p. 4 and 21).

that counsel for the Commissioner is asking this Court to do is to draw different inferences from the evidence before the Board of Tax Appeals than were drawn by that Board. There can be no question that there is ample evidence in the record to support the inferences drawn by the Board and its ultimate findings. The Court of Appeals affirmed the decision of the Board. Even if it were open to this Court, as it is not under its decisions, to weigh the evidence, the decision of the Board, affirmed by the Court of Appeals, would be entitled to the greatest weight. The principle is also applicable that the courts lean, in case of doubt, to an interpretation that the transaction is a mortgage. But, as before shown, this Court does not review the weight of the evidence; it determines only if a correct rule of law was applied and whether there was substantial evidence to support the findings of the Board under the applicable principles of law. As the correct rule of law was applied to the facts found by the Board and there was substantial evidence to support its findings, the decision of the Circuit Court of Appeals should, therefore, be affirmed.

Respectfully submitted,

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APPENDIX

Revenue Act of 1928, c. 852, 45 Stat. 791:

Sec. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(k) Depreciation.—A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence. In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. In the case of property held in trust the allowable deduction shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each.

SUPREME COURT OF THE UNITED STATES.

No. 56.—October Term, 1939.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, vs. The F. & R. Lazarus & Company. } On Writ of Certiorari to the United States Circuit Court of Appeals for the Sixth Circuit.

[December 4, 1939.]

Mr. Justice Black delivered the opinion of the Court.

In computing its net taxable income for 1930 and 1931, respondent claimed depreciation on three buildings occupied and used in its business as a department store. During those years, the legal title to two of these properties and an assignment of a ninety-nine year lease to the third were in a bank as trustee for certain land-trust certificate holders. These properties had been transferred to the trustee by the respondent in 1928 and the trustee had at the same time leased all three back to respondent for ninety-nine years, with option to renew and purchase. In claiming the deduction, respondent insisted that the capital loss from wear, tear, and exhaustion of the buildings was falling upon it, thus entitling it to the statutory allowance for depreciation of buildings.[1] The Commissioner disallowed this deduction on the ground that the statutory right to depreciation follows legal title. Reviewing the evidence, the Board of Tax Appeals concluded that the transaction between respondent and the trustee bank was in reality a mortgage loan and ordered the deduction allowed,[2] and the Circuit Court of

[1] Revenue Act of 1928, c. 852, 45 Stat. 791, 799-800. In computing net income there shall be allowed as deductions:

Depreciation.—A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence. In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. In the case of property held in trust the allowable deduction shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each.

[2] 32 B. T. A. 633. The Board found the depreciable life of the property to be fifty years, instead of forty as originally claimed by respondent.

Appeals affirmed.[3] Upon facts which it considered "in all essential respects identical," the Court of Appeals for the District of Columbia held depreciation not allowable.[4] Because of the different results reached by the Courts of Appeal, we granted certiorari.[5]

The Federal income tax is aimed at net income determined from gross income less items such as necessary expenses incurred or capital consumed in earning it. Thus, the controlling statute permits a taxpayer in computing net income to deduct a "reasonable allowance for . . . exhaustion, wear and tear." While it may more often be that he who is both owner and user bears the burden of wear and exhaustion of business property in the nature of capital, one who is not the owner may nevertheless bear the burden of exhaustion of capital investment. Where it has been shown that a lessee using property in a trade or business must incur the loss resulting from depreciation of capital he has invested, the lessee has been held entitled to the statutory deduction.[6]

Here, the taxpayer used business property in which it had a depreciable capital investment, provided it had not recovered its investment through a sale. The Board in substantial effect found that the instrument under which the taxpayer purported to convey legal ownership to the trustee bank was in reality given and accepted as no more than security for a loan on the property; the "rent" stipulated in the concurrently executed ninety-nine year "lease" back was intended as a promise to pay an agreed five per cent interest on the loan; and the "depreciation fund" required by the "lease" was intended as an amortization fund, designed to pay off the loan in forty-eight and one-half years. These findings are supported by evidence which permits, at most, conflicting inferences and are, therefore, conclusive here. And, unless the Board committed error of law we must affirm.[7]

We think the Board justifiably concluded from its findings that the transaction between the taxpayer and the trustee bank, in writ-

[3] 101 F. (2d) 728; cf. Commissioner v. H. F. Neighbors Realty Co., 81 F. (2d) 173.

[4] City National Bank Building Co. v. Helvering, 98 F. (2d) 216, 217.

[5] — U. S. —.

[6] Duffy v. Central R. Co. of N. J., 268 U. S. 55; Appeal of Gladding Dry Goods Co., 2 B. T. A. 336, 338; Cogar v. Commissioner, 44 F. (2d) 554. See, Bowman-Co. v. Commissioner, 32 F. (2d) 404, 405; Nat'l City Bank of Seattle v. United States, 64 C. Cls. 236, cert. den. 276 U. S. 620; Commissioner v. H. F. Neighbors Realty Co., *supra*.

[7] 26 U. S. C. 641(c).

ten form a transfer of ownership with a lease back, was actually a loan secured by the property involved. General recognition has been given the "established doctrine that a court of equity will treat a deed, absolute in form, as a mortgage, when it is executed as security for a loan of money."[8] In the field of taxation, administrators of the laws and the courts are concerned with substance and realities, and formal written documents are not rigidly binding. Congress has specifically emphasized the equitable nature of proceedings before the Board of Tax Appeals by requiring the Board to act "in accordance with the rules of evidence applicable in courts of equity of the District of Columbia." 26 U. S. C. 611. The Government relies in part upon *Senior* v. *Braden*, 295 U. S. 422. Whatever the significance of that case, it can have no application here. In the *Braden* case, the equitable doctrine—here controlling—of looking to extrinsic evidence behind a transfer absolute on its face to determine whether only a security transaction was contemplated by the parties, was neither invoked nor passed upon.

Judgment below is

Affirmed.

Mr. Justice REED took no part in the consideration or decision of this case.

A true copy.

Test:

Clerk, Supreme Court, U. S.

[8] Pugh v. Davis, 96 U. S. 332, 336; Hughes v. Edwards, 9 Wheat. 489, 495; Russell v. Southard, et al., 12 How. 139; Teal v. Walker, 111 U. S. 242. See cases collected in 79 A. L. R. 937.